

**Testimony – In Support  
House Bill No. 116  
Introduced by Rep. Pat Ingraham  
By Request of the Teachers' Retirement System**

EXHIBIT #3  
DATE Jan. 18<sup>th</sup> 2011  
HB 116

**House State Administration  
January 18, 2011  
Presented by David L. Senn  
Executive director Teachers' Retirement System**

By now, most everybody in America has seen and read media exposés describing the financial problems of state and local pension funds. We all agree that the pension fund deficit caused by the 2008 and 2009 decline in the market value of retirement assets must be addressed; the question is, how and when? The good news is that the Teachers' Retirement System (TRS) is not going to run out of money in the next two, 10 or 15 years. While we have time to address the problem, we need to get started now.

House Bill 116 will address the current underfunding in two ways. First, HB 116 would phase in an increase in the State's supplemental contribution rate of 0.50% per year through July 1, 2023 (unless the amortization period is less than or equal to 30 years). Second, HB 116 includes several amendments that would strengthen actuarial controls where weaknesses have been found, which can have an adverse impact on funding. However, while HB 116 moves us in the direction of actuarially funding TRS, it does not immediately increase contributions to the degree that would be necessary to meet the Actuarially Required Contribution (ARC) rate in the next biennium. The actuaries have estimated that the ARC would need to increase by 2.20% effective July 1, 2011, and by another 2.02% effective July 1, 2012, for a total of 4.22% over the next biennium. This is important to keep in mind, as I will address the ARC in more detail later on in my testimony.

First, let me address what I am calling "actuarial controls". These are actuarial factors or controls based on actuarial determinations that are codified in statute. HB 116 will strengthen these actuarial controls to avoid future losses and/or overpayment of retirement benefits.

### **Section Summary**

#### **Sections 1 & 11 – Working Retiree Controls:**

- Establishing employer liability regarding reports relating to retired members
  - Employers who do not timely and correctly report could be held jointly and severally liable with the retired member for any repayment due TRS.
- Amending provisions governing retirees returning to work in a TRS eligible position
  - Discontinue consideration of employment status for retirees returning to work in a TRS eligible position (part-time or full-time service), leaving only the one-third compensation limitation for working retirees.
  - If a retiree is employed under the one-third earnings limit in a TRS-reportable position and is concurrently employed by the same employer in a position that, on its own, would

not be a TRS-reportable position, the positions and compensation would be deemed to be combined as a single TRS-reportable position.

**Sections 2 through 8 – Effective July 1, 2012, Charge the Actuarial Interest Rate on all Service Purchases:**

- Changing the actuarial interest rate on all service purchase agreements initiated on or after July 1, 2012
  - For members hired prior to July 1, 1989, current law limits the rate of interest charged on service purchase agreements to the rate credited to the member's account. With the current rate credited to member's accounts at only 0.25%, these service purchases are significantly underfunded. Therefore, all sections of current law governing service purchase agreements are amended to charge the actuarial assumed rate (currently 7.75%). This change would only affect purchase agreements that are effective after July 1, 2012. Members hired after July 1, 1989, are currently required to pay the full actuarial cost for most service purchases.

**Section 9 – Increase State Supplemental Contribution Rate:**

- Increasing the state supplemental contribution to the retirement system
  - Increase the State general fund TRS contribution, effective July 1, 2011, by 0.50% per year through 2023, or until the unfunded liabilities can be amortized over 30 years or less.

**Section 10 – 10% Cap Exemptions:**

- Revising caps on compensation that can be used in the calculation of average final compensation
  - Eliminate all exceptions to the 10% cap, except for an increase that results from movement on an employer adopted salary matrix.

**Section 12 – Full Actuarial Reduction for Early Retirement:**

- Updates the current actuarial factors for early retirement
  - Members electing to retire early (less than 25 years of service or less than age 60) receive a reduced "early" retirement benefit. The reduction is 0.5% for the first 60 months early and 0.3% for each additional month. The maximum reduction is 48.0%. The Actuaries recommend Early Retirement Factors should be true actuarially equivalent factors so that the system does not subsidize early retirement for the member. The following examples show how benefits would be affected by the proposed change.

### Early Retirement Factors, Current & Proposed

Age								
At	5 Years of Service		10 Years of Service		15 Years of Service		20 Years of Service	
Retirement	Current	Proposed	Current	Proposed	Current	Proposed	Current	Proposed
50	0.5200	0.4080	0.5200	0.4080	0.5200	0.4080	0.7000	0.6312
55	0.7000	0.6312	0.7000	0.6312	0.7000	0.6312	0.7000	0.6312
58	0.8800	0.8291	0.8800	0.8291	0.8800	0.8291	0.8800	0.8291
59	0.9400	0.9100	0.9400	0.9100	0.9400	0.9100	0.9400	0.9100
60	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000

### Actuarial Required Contributions (ARC)

We all recognize that funds are in short supply this Session, with needs and desires far greater than available funding. Therefore, if the additional funding required to phase in the Actuarially Retired Contribution rate increase cannot found this session, we understand the sponsor's offer to strike section 9 of HB 116. However, if we cannot begin to fund the ARC now, the required rate increase most likely will continue to grow, thus increasing the size of the problem the next Legislature will have to address. In addition, failure to contribute the ARC could have an adverse impact on the State's credit rating; although, I believe if the legislature starts to address the problem now it is far less likely the State's credit rating would be affected. This belief is supported by a recent press release from Fitch:

"The analysis of long-term obligations, including pensions, is an important part of Fitch's rating review for state and local government credits. Fitch has downgraded a number of credits due in part to pension funding issues, and will continue to take such action as warranted...."

"However, since governments and their tax bases are long-term in nature, officials in most cases have some time to fully implement changes to control their long-term liabilities. Similarly, the beneficial impact of any adjustments on funding levels and contributions will accrue over an extended period."

"In analyzing state and local government pension obligations and the impact on overall credit quality, key factors that Fitch reviews include the size of the resource base from which funding is derived, the amount of the government's budget needed to make pension payments, and officials' willingness and ability to make hard choices to bring assets and liabilities into better balance. These factors are not positive for all governments, and more will see rating declines as options become even more limited as time passes."

"Although a pressing need remains to set many pension systems on a more sustainable footing, what Fitch has observed over a long period of time is generally responsible financial management actions by state and local governments, and Fitch believes officials will work in the near term to improve funded ratios."

### Fiscal Note

The fiscal note shows both the impact of strengthening the actuarial controls and the cost of increasing the State's supplemental contribution rate over the next 4 years.